

AR60

Winspear Business Reference Room  
University of Alberta  
1-18 Business Building  
Edmonton, Alberta T6G 2R6



# SCIMITAR HYDROCARBONS CORPORATION

**ANNUAL REPORT**

**FOR THE TWELVE MONTHS  
ENDED JUNE 30, 1996**

# CORPORATE PROFILE

Scimitar Hydrocarbons Corporation is a Canadian-based junior international oil and gas company that commenced operations in late 1995. Its common shares trade on The Alberta Stock Exchange under the symbol "SIY".

## SCIMITAR'S PHILOSOPHY

*Through its principals' extensive network, Scimitar acquires large initial working interests in medium-size prospects outside North America, within areas which have proven hydrocarbon potential.*

*Scimitar selects those projects which have the most significant unrecognized value, and then employs the best technical and business methods to conduct front-end work which cost-effectively demonstrates the upside value inherent in those projects.*

*After completion of the front-end work, Scimitar will normally bring in qualified co-venturers to cooperate in the capital-intensive follow-on programs, and to carry out long-term production operations.*

## LIST OF ABBREVIATIONS

BC	Barrels condensate
BOE	Barrels oil equivalent, energy basis
C\$	Canadian Dollars
/d	Per day
ENH	Empresa Nacional de Hidrocarbonetos de Mozambique (National petroleum company)
LNG	Liquefied natural gas
MoU	Memorandum of Understanding
PSA	Production Sharing Agreement
SHC	Scimitar Hydrocarbons Corporation
SPIL	Scimitar Production International Ltd. (100%-owned subsidiary of SHC)
SPL	Scimitar Production Ltd.
TCF	Trillions of cubic feet of natural gas
US\$	United States Dollars

## TABLE OF CONTENTS

Message to the Shareholders	1
Review of Operations	4
Financial Statements and Notes	9
Corporate Information	<i>Inside Back</i>



# MESSAGE TO THE SHAREHOLDERS

Scimitar's first year of operation has been exciting and productive. Scimitar has developed from what was virtually a shell having assets with mainly latent value, into a full-fledged start-up company with tangible projects, a modest level of field programs, and a small, dedicated, core group of staff and key contractors.

Scimitar exists to provide you, its shareholders, with superior returns on your investment, and will focus on applying its strengths to those areas of the international petroleum industry where it can be most successful – and profitable.

## KEY EVENTS TO MID-OCTOBER, 1996

- Scimitar Hydrocarbons Corporation commenced operations in November, 1995, through a reverse takeover of Commonwealth Energy Inc. and subsequent name change.
- Scimitar's successful equity offerings have generated a total of approximately C\$5.4 million for investment, through private placements in November, 1995 (C\$1.7 million) and September, 1996 (C\$3.0 million), together with the exercise of warrants in May, 1996 (C\$0.7 million).
- Scimitar's Production Sharing Agreement for the large 2.1 million acre Buzi-Divinhe Block in Mozambique became effective Jan. 1, 1996. Scimitar immediately launched a major seismic data acquisition program.
- Scimitar experienced mixed results with a well workover in the United Arab Emirate of Ajman, in early 1996. While the well's production was substantially increased and valuable technical information gained, results fell short of expectations.
- Scimitar reached advanced stages of negotiations for acquisition of additional projects in the Middle East and northern Africa. These crude oil exploitation projects are beyond the exploration-risk stage and would provide accelerated cash flow and a more balanced project portfolio.
- Scimitar positioned itself for future success, by strengthening its executive and technical teams in a reorganization put into place in October, 1996.

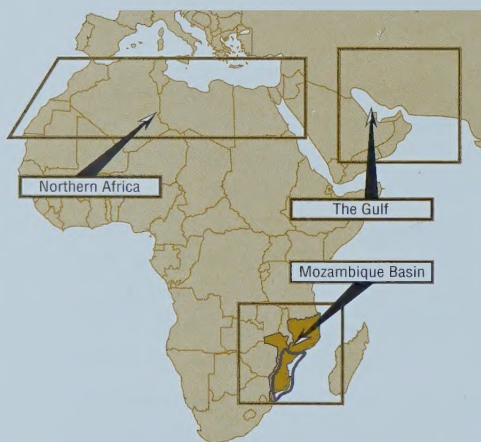
## INDUSTRY CONDITIONS

Industry trends point toward a future which is ideally suited to Scimitar's niche strategy.

Even though crude oil prices were strong through 1996, Scimitar's expectations regarding the cyclical nature of oil prices form a basis for the Company's commitment to rigorously drive down costs in all areas of our operation. In a commodity business "The low cost explorer/producer wins". I believe Scimitar is well positioned to drive costs down, through its bottom-line focused business approach coupled with appropriate application of the latest technological advances – in many cases these will be technologies developed recently in the extremely competitive western Canadian sedimentary basin. Scimitar is able to rapidly access these leading-edge technologies through its network of highly skilled contractors.

*Scimitar  
raised and  
began to invest  
C\$5.4 million  
in international  
projects...*

*Scimitar  
is currently focusing  
on projects in  
Mozambique, the Gulf  
and northern Africa...*



During 1996, the world natural gas business made large strides forward. Overall gas demand was robust, and a variety of important natural gas infrastructure projects in Europe, Asia, and Africa achieved critical milestones. These developments are especially important for an infrastructure-driven business like natural gas. Consequently, Scimitar plans to continue to consider carefully selected natural gas projects to balance crude oil projects in its portfolio.

The North American oil and gas business is expected to remain very competitive, with numerous companies of all sizes, and few barriers to entry. For this reason, and to make best use of its principals' extensive international network, Scimitar intends to continue its focus on being an exclusively international company, without any North American petroleum assets. Scimitar is actively developing several projects in northern Africa and the Gulf, to diversify beyond and complement its current focus areas in the Gulf and Mozambique.

The past year also witnessed the continued opening up of countries formerly closed to private-sector petroleum companies. The world's largest petroleum companies moved further into areas of the former Soviet Union and northern South America, paying large premiums for the opportunity to access potential megaprojects. Scimitar plans to keep its project front-end costs under control, by avoiding areas that have already become industry "hot spots" and by focusing on mid-size projects, essentially "flying under the radar" of major competitors.

## ORGANIZATION

In October, 1996, Scimitar revised its organizational structure, to position itself for profitable growth. The following Executive Committee was appointed, reporting to the Board of Directors:

Managing Director	Mark R. Smith
Director, Operations	John L. Dragonetti
Director, Projects	Gordon D. Holden
Director, Technical	Grant H. Grimsrud
Director, Investor Relations	Bill G. Calsbeck

This Executive Committee will be responsible for day-to-day operations of the Company, as well as for ongoing development of business strategies in conjunction with the Board of Directors. These Executive Committee members are operational directors only and not members of the Company's Board of Directors, with the exception of Mark R. Smith.

Consistent with Scimitar's shareholder-value focus, compensation for the persons listed above has been designed to ensure alignment between executive and shareholder objectives: modest levels of cash compensation are supplemented by more substantial share price-based incentive components.



*Scimitar  
plans to screen  
more than a dozen  
new projects  
each year...*

## OUTLOOK

As described in the Review of Operations, Scimitar has, in its first year, begun to establish itself as a viable player in the international upstream petroleum industry. Over the next year, Scimitar plans to bring its current first group of projects to the stage where qualified partners can be brought in to cooperate in funding the subsequent capital-intensive stages of drilling and geophysical work, and later to conduct the ongoing production operations.

As well, over the next year Scimitar will continue to assess a wide variety of additional opportunities, for its next cycle of projects. We expect to screen between 12 and 20 projects (or more) on a cursory basis every year, to examine perhaps 10 of them in detail, to develop four into concrete proposals, and to "green-light" two of them forward to the implementation stage. Scimitar sees the world to be opportunity-rich for companies our size and with our attributes – the constraints will be the availability of sufficient financial and technical resources. Consequently, our high-grading process is vital to achieving superior profitability, and we have emphasized this factor in the selection and mandate of our new Executive Committee.

Several years after the green-light point for each batch of projects, Scimitar would expect to have farmed-down to a modest non-Operator working interest requiring for the most part only a maintenance effort by Scimitar. This should enable us to grow reserves, production, and profits, without correspondingly growing overhead costs. Using this approach, Scimitar intends to stay lean, agile, and cost-conscious.

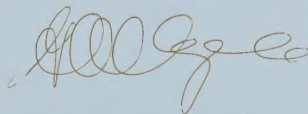
## ACKNOWLEDGMENTS

Scimitar's first year has been one of great progress – progress which would not have been possible without the continued support of our worldwide shareholders, and the technical and commercial excellence, and personal dedication, of Scimitar's core group of employees and key contractors.

We thank you, and all of them, and renew our commitment to significantly increasing shareholder value through our projects in the international oil and gas development and exploration industry.

We wish to acknowledge the great assistance provided to Scimitar by former Board of Directors member Lorne Torhjem, who is now pursuing other interests.

*Submitted on behalf of the Board of Directors:*



Gerald A. Mackenzie,  
Chairman of the Board

Calgary, Canada  
October 17, 1996

# REVIEW OF OPERATIONS

## MOZAMBIQUE

Mozambique represents a possible “grand slam” opportunity for a company like Scimitar: a large land block in a potentially world-class hydrocarbon basin that has for many years been out-of-bounds to modern exploration and exploitation programs.

Scimitar was the first western upstream petroleum company to make significant commitments on the basis of recognition that Mozambique had “turned the corner” with UN, World Bank, and other international assistance. Since that time, other upstream and gas project development companies from the USA, UK, Canada, and elsewhere have moved into Mozambique – in effect validating Scimitar’s early move.

Mozambique’s political environment continues to improve, placing the country in that relatively stable portion of Africa below the Equator. Mozambique has become increasingly active in organizations like SADC (South African Development Community), and has gained membership in the British Commonwealth. Mozambique remains, however, an undeveloped country – one which is eager to attract private-sector investment, and it is currently revamping its legal framework to reflect its increasingly pro-business orientation.

Scimitar’s pre-emptive move allowed it to acquire a 50% production working interest in the 2.1 million acre onshore Buzi-Divinhe Block, effective January 1, 1996. This interest may be increased to 75% in new reserves, subject to completion of certain work commitments.

The Buzi-Divinhe Block was selected for several compelling reasons:

- The Block’s immediate proximity to the world-scale Pande gas fields, less than 45 km away.
- The presence of the small, undeveloped Buzi gas and gas condensate field in the northern extremity of the Block (discovered by Gulf Mozambique in 1962).
- The existence of extensive vintage seismic and well log data that indicated the possibility for a gas and gas condensate-prone fairway between the Pande fields and the Buzi field.
- The applicability of sophisticated modern geophysical techniques to cost-effectively test the upside potential of this large land block.
- The relatively good infrastructure and access to the area, as the Block includes Beira, Mozambique’s second largest port and industrial city, as well as the industrial logistics corridor from Beira to the nearby Zimbabwean capital of Harare.
- Reasonable terms for cost recovery, production sharing, and taxes under a modern Production Sharing Agreement format.

The Buzi-Divinhe Block fits ideally with Scimitar’s philosophy of targeting mid-size international prospects which are suitable for application of modern technical methods, in basins with established hydrocarbon potential.

*Currently  
Scimitar’s most  
significant project is its  
Buzi-Divinhe Block in  
Mozambique...*



# MOZAMBIQUE

BUZI-DIVINHE BLOCK  
& INHAMINGA BLOCK

MOZAMBIQUE

HARARE

Beira-Harare  
Logistics Corridor

ZIMBABWE

PORT of BEIRA  
BUZI GAS FIELD

INHAMINGA BLOCK  
Area: 4,173,000 acres  
Equiv. to 16,300 sq. km

BUZI-DIVINHE BLOCK  
Area: 2,139,000 acres  
Equiv. to 8,355 sq. km

PANDE GAS FIELD

TEMANE GAS FIELD

Proposed  
Enron  
Pipeline

MAPUTO

SWAZILAND

SOUTH AFRICA

Approx. Edge of  
Mozambique  
Sedimentary Basin





*Scimitar  
is conducting an  
extensive seismic  
program in the  
Buzi-Divinhe Block...*



The Buzi-Divinhe Block is an exciting prospect for Scimitar, because the Block is now at its point of best value leverage – the point where the potential asset value increase is very large relative to the amount of risk capital being invested. At the same time, Scimitar also has the crucial benefit of several risk-mitigating factors: (a) close proximity to major established reserves, (b) a defined hydrocarbon-prone fairway, and (c) available vintage seismic and well data covering key portions of the Block.

### Buzi-Divinhe Block Seismic Program

Scimitar moved immediately into action upon signing the Buzi-Divinhe Block Production Sharing Agreement at the end of 1995. In cooperation with the Mozambican national petroleum company, ENH, Scimitar rapidly designed a wide-ranging seismic program to test the main prospects identified using the vintage seismic and well control data. Upon completion of the 1996 program, Scimitar will have fully met the spending and work commitments for the First Extension Period to the PSA.

Scimitar's seismic program has been designed to apply a powerful direct hydrocarbon indicator technique, to substantially increase the Buzi-Divinhe Block's risk-adjusted reserve potential. The ultimate potential of the Block could include extremely large reserves of gas (plus condensates and gas liquids); however, the confidence level in such large reserves is currently relatively small as there is no modern data over the Block. Results of the 1996 seismic program will support significantly higher confidence levels – and lower risk adjustments – to subsequent reserve potential estimates, though the maximum, unrisks, potential reserve number is expected to decrease. The net effect of this process is expected to be an increase in the net asset value of the Block.

This seismic program exemplifies one of the most important tenets of Scimitar's philosophy: driving risk-capital costs down and reducing risk through application of appropriate technologies. Scimitar is processing its seismic data in the field, using state-of-the-art portable computer systems. This field-processed seismic data is transferred overnight from the field, using data compression/encryption and a satellite communication system, to Calgary-based geophysical staff who assess the results and immediately make necessary adjustments to the balance of the program design. This working method allows Scimitar to delete those lines found to be less promising and to redeploy more lines onto the best prospects. As a result, Scimitar will be able to acquire far less seismic data than would typically be required, and to monitor the technical quality of the job from Calgary.

Field seismic data acquisition commenced in August 1996, with final results expected to be available for release in late 1996 or early 1997. Planning of 1997 drilling and geophysical follow-up work will begin immediately thereafter, and negotiations with potential co-venturers will accelerate.



*Market  
development  
work will accelerate,  
once potential reserve sizes can  
be better estimated  
based upon results of the  
1996 seismic  
program...*

### Buzi Gas / Gas Condensate Field Early Development Project

Once results of the 1996 seismic program are available, decisions will be made regarding potential early development of the small, undeveloped Buzi gas and gas condensate field within the northern portion of the Block. Scimitar plans to book no reserves for this field until further testing has been conducted.

### The Inhaminga Block

Based on its preliminary assessments of opportunities in Mozambique and elsewhere, Scimitar entered into an October 1996 Memorandum of Understanding (MoU) for the Inhaminga Block. The Inhaminga Block adjoins the entire northern border of Scimitar's Buzi-Divinhe Block, straddling the logistics corridor between Beira and Harare.

Like the Buzi-Divinhe Block, the Inhaminga Block is demonstrably hydrocarbon prone, with a series of wells having been drilled in the early 1900s, including a reported gas well blowout. These drilling tests, together with a vintage geophysical data grid, provide a basis for Scimitar's current technical evaluations into the potential upside value of the Block.

The Inhaminga MoU provides Scimitar with an exclusive, no-obligation option to add an additional 4.2 million acres to its asset portfolio – at very low cost. Favorable terms for the prospective PSA have also been pre-defined in the MoU.

Scimitar plans to decide by mid-1997 whether to exercise its option to enter into a PSA and subsequent work programs for the Inhaminga Block.

### Marketing and Transportation

An opportunity of this scale must naturally come with a challenge – in the case of Mozambique, the currently immature regional gas markets.

Scimitar has conducted preliminary reviews of local gas markets. Small-scale markets for power generation and industrial fuel exist in the vicinity, and have the attractive feature of being relatively quick to put on-stream (probably less than two years from approval to proceed). As well, considerable potential exists for ammonia or gas chemicals production, probably at the port of Beira or in adjacent Zimbabwe. Several potential sponsors for projects of this type have already been in communication with Scimitar.

If world-scale reserves are discovered on the Buzi-Divinhe Block, the most profitable markets are likely off-shore, typically via a methanol plant or possibly a liquefied natural gas ("LNG") facility. The Buzi-Divinhe Block's tidewater gas should be cost competitive with other suppliers, and would have the advantage of free-sailing to markets (in contrast to several current LNG suppliers which must ship through politically sensitive waterways). Large projects of these types take five or more years to bring to production from the date of approval, and Scimitar would intend to confine itself solely to the upstream portions.

*Scimitar  
is currently  
finalizing terms for  
two crude oil  
projects...*

Scimitar plans to accelerate marketing activities once potential reserves are better understood on the basis of results from its 1996 Buzi-Divinhe Block seismic program. Positive signs are already becoming evident. An Enron company has signed various agreements with Mozambican agencies for the proposed development of a large pipeline project for shipment of Pande field gas to markets in nearby South Africa. This project is timetabled to lead to first production in 1998 or 1999, and Scimitar has already initiated discussions with the project sponsors regarding gas from its Buzi-Divinhe Block.

Recently, another large United States-based petroleum company signed agreements which could lead to development of key gas supply infrastructure from the Temane gas field (adjacent to the Pande fields).

### **AJMAN, UNITED ARAB EMIRATES**

Early in 1996, Scimitar worked-over the onshore Ajman #2 condensate well, in an attempt to stimulate up to a 10- or 20-fold production rate increase over the initial 20 BC/d. While the program was executed on-budget and provided valuable technical information, only an approximate doubling of production was achieved after the well stabilized.

As part of an arrangement with the Government of Ajman, Scimitar is currently not taking ownership of the small amount of production from the well. Scimitar will look to farm-out further work in its Ajman Concession.


### **OTHER PROJECTS**

Scimitar has reviewed numerous additional projects through the last year, and currently has brought two crude oil projects to the point where the terms of a Memorandum of Understanding for each are being finalized at the time of writing in October, 1996.

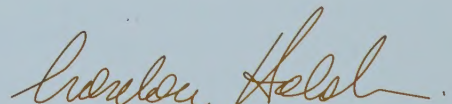
These oil projects are an ideal fit for Scimitar. They include known reserves subject primarily to recovery rate risk, and would provide balancing crude oil reserves for Mozambican gas, comparatively early cash flows, and additional geographical diversification. These are the kind of mid-size projects that are well-suited to the application of cost-effective oil exploitation techniques developed in the western Canadian sedimentary basin over the past decade.

As these projects have not yet been awarded to Scimitar at the time of writing, further details can be released only after such time as the corresponding MoUs are in place.

*Submitted on behalf of the Executive Committee:*



Mark R. Smith  
Managing Director  
Calgary, Canada  
October 17, 1996



Gordon D. Holden  
Director, Projects





# FINANCIAL STATEMENTS

## MANAGEMENT'S REPORT TO THE SHAREHOLDERS

The financial statements of Scimitar Hydrocarbons Corporation were prepared by Management in accordance with accounting principles generally accepted in Canada, and are consistent with the financial and operating information presented in this Annual Report.

Management maintains a system of internal controls to provide suitable assurance that all assets are safeguarded and to enable preparation of reliable and timely financial statements for reporting purposes. Timely disclosure may require the use of estimates, in cases where transactions affecting the current reporting period cannot be finalized or known for certain until future periods. Such estimates are based on judgments made by Management, using all relevant information known at the time.

External auditors appointed by the shareholders have examined the corporate and accounting records in order to express their opinion on the financial statements. The Audit Committee has met with the external auditors and Management to determine if Management has fulfilled its responsibilities in the preparation of these financial statements. The Audit Committee has reported its findings to the Board of Directors who have approved the financial statements.

Mark R. Smith, Managing Director

Gordon D. Holden  
Director, Projects

## AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of Scimitar Hydrocarbons Corporation as at June 30, 1996 and the consolidated statements of operations, deficit and changes in financial position for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at June 30, 1996 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

Chartered Accountants

Calgary, Canada  
October 8, 1996





## CONSOLIDATED BALANCE SHEET

(Expressed in Canadian Dollars)	1996	1995
		(Unaudited)
<b>Assets</b>		
Current assets:		
Cash and short term deposits	\$ 207,504	\$ 240
Accounts receivable	58,214	2,529
Prepaid expenses	6,000	—
Marketable securities (market value \$ 195,818)	156,768	—
	428,486	2,769
Capital assets (note 4)	4,263,994	2,583,793
Goodwill, net of amortization	155,500	—
	<u>\$ 4,847,980</u>	<u>\$ 2,586,562</u>
<b>Liabilities and Shareholders' Equity</b>		
Current liabilities:		
Accounts payable	\$ 454,481	\$ 201,225
Due to related parties (note 5)	—	298,947
	454,481	500,172
Shareholders' equity:		
Share capital (note 6)	4,708,244	2,086,390
Deficit	(314,745)	—
	4,393,499	2,086,390
Basis of presentation (note 1)		
Subsequent event (note 8)		
	<u>\$ 4,847,980</u>	<u>\$ 2,586,562</u>

See accompanying notes to consolidated financial statements.

For the 12 months ended June 30, 1996  
Comparative figures for 1995

## CONSOLIDATED STATEMENT OF OPERATIONS

(Expressed in Canadian Dollars)	1996	1995
		(Unaudited)
Corporate items:		
Corporate expenditures	\$ 188,021	\$ —
Amortization of goodwill	44,500	—
Write-down of marketable securities	71,000	—
Depreciation of furniture and equipment	11,224	—
Net loss for the period	<u>\$ 314,745</u>	<u>\$ —</u>
Loss per share	<u>\$ 0.03</u>	<u>\$ —</u>

See accompanying notes to consolidated financial statements.





**SCIMITAR HYDROCARBONS CORPORATION**  
For the 12 months ended June 30, 1996  
Comparative figures for 1995

## CONSOLIDATED STATEMENT OF DEFICIT

(Expressed in Canadian Dollars)	1996	1995
Deficit, beginning of period	\$ -	\$ -
Net loss	314,745	-
Deficit, end of period	<u>\$ (314,745)</u>	<u>\$ -</u>

See accompanying notes to consolidated financial statements.

For the 12 months ended June 30, 1996  
Comparative figures for 1995

## CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(Expressed in Canadian Dollars)	1996	1995
		(Unaudited)
Cash provided by (used in):		
Operations:		
Net loss	\$ (314,745)	\$ -
Depreciation and amortization	55,724	-
Write-down of marketable securities	71,000	-
	<u>(188,021)</u>	<u>-</u>
Investing:		
Additions to capital assets	(1,691,425)	(2,583,793)
Change in non-cash working capital	(36,197)	198,696
	<u>(1,727,622)</u>	<u>(2,385,097)</u>
Financing:		
Issue of common shares	2,621,854	2,086,390
Issue (repayment) of note payable	(298,947)	298,947
Goodwill	(200,000)	-
	<u>2,122,907</u>	<u>2,385,337</u>
Increase in cash and short-term deposits	<u>\$ 207,264</u>	<u>\$ 240</u>
Cash, beginning of period	240	-
Cash and short-term deposits, end of period	<u>\$ 207,504</u>	<u>\$ 240</u>

See accompanying notes to consolidated financial statements.

Submitted on behalf of the Board of Directors:

Mark R. Smith,  
Director

Angus A. Mackenzie  
Director

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## INCORPORATION:

Scimitar Production International Ltd. ("SPIL") was incorporated on March 15, 1995 in the British Virgin Islands. On November 10, 1995, SPIL was acquired by Commonwealth Energy Inc., a company incorporated under the Alberta Business Corporation Act. This acquisition was accounted for as a reverse take-over and the name of the combined companies was changed to Scimitar Hydrocarbons Corporation on January 2, 1996 (see note 3).

## 1. Basis of presentation:

These consolidated financial statements are expressed in Canadian dollars and are prepared in accordance with accounting principles generally accepted in Canada.

These consolidated financial statements include the accounts of the Company and those of its wholly-owned subsidiary. The unaudited comparative figures for the period ended June 30, 1995 are those of SPIL.

The Company's activities to date have been directed toward the exploration for and development of petroleum and natural gas properties. The Company has acquired interests in undeveloped petroleum and natural gas properties in Mozambique and the United Arab Emirates ("UAE"). Planned principal operations have not commenced in either location and are considered by management to be in the preproduction stage. As a result all costs associated with such activities, net of revenues have been capitalized as exploration costs as a component of capital assets (note 4). The ultimate recovery of the Company's investment is dependent upon the discovery of petroleum and natural gas reserves in commercial quantities and the availability of necessary financing to complete the exploration and development of its holdings. Those costs associated with general corporate overhead are expensed in the period in which they are incurred.

## 2. Significant accounting policies:

### (a) Capital assets:

The Company follows the full cost method of accounting for petroleum and natural gas operations whereby all costs of exploring for and developing petroleum and natural gas properties and related reserves are capitalized into a cost centre for each country in which the Company has operations. Such costs include land acquisition costs, costs of drilling both productive and non-productive wells, geological and geophysical expenses and well equipment.

Upon achieving commercial production, capitalized costs will be depleted using the unit-of-production method based on estimated proven reserves of petroleum and natural gas before royalties as determined by an independent engineer. For purposes of the depletion calculation, natural gas reserves and production are converted to



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

equivalent volumes of crude petroleum based on the approximate relative energy content.

Gains or losses on the sale or disposition of petroleum and natural gas properties are not ordinarily recognized except under circumstances which result in a major revision of depletion rates.

The Company will annually apply a "ceiling test" to capitalized costs to ensure that such costs do not exceed future net revenues from estimated production of proven reserves, using prices and costs in effect at the Company's year end. Future net revenues are calculated after deducting general and administrative costs, financing costs, income taxes and future site restoration and abandonment costs.

Estimated future site restoration and abandonment costs, net of expected recoveries, are provided over the life of the proved reserves using the unit-of-production method. Costs are estimated each year by management based on current regulations, costs, technology and industry standards. The annual charge is included in depletion and actual removal and site restoration expenditures are charged to the accumulated provision account as incurred.

Certain of the Company's exploration and production activities are conducted jointly with others and, accordingly, the accounts reflect only the Company's proportionate interest in such activities.

Depreciation of furniture and equipment is based on estimated useful life and is calculated using the declining balance method at rates of 20% to 40%.

### (b) Goodwill:

Goodwill represents the excess of the purchase price over the fair values of net assets acquired on the acquisition of Commonwealth. The costs are amortized using the straight-line method over a three year period from the acquisition date.

### (c) Marketable securities:

Marketable securities are recorded at the lower of cost and market at the balance sheet date.

### 3. Business combination:

On November 10, 1995, the shareholder of SPIL entered into an agreement with Commonwealth Energy Inc. ("Commonwealth") whereby the shareholder agreed to sell 100% of its shares of SPIL in exchange for 5,000,000 common shares of Commonwealth (note 6). The consolidated financial statements have been prepared on the basis that control of the combined companies passed to the shareholder of SPIL. This form of business combination is referred to as a "reverse takeover" and SPIL is regarded as the acquirer of Commonwealth. Accordingly, control of the assets and business of Commonwealth were acquired in consideration for the issuance of shares of SPIL.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

The acquisition has been accounted for using the purchase method whereby the consolidated financial statements reflect the assets, liabilities and shareholders equity of SPIL at historic amounts and the assets and liabilities of Commonwealth at fair values as follows:

Cash	\$	177,000
Goodwill		200,000
Consideration – common shares	\$	377,000

### 4. Capital assets:

	1996	1995
		(Unaudited)
Undeveloped petroleum and natural gas properties:		
Mozambique	\$ 1,323,481	\$ 646,883
United Arab Emirates	2,860,431	1,936,910
Other	55,005	–
Furniture and equipment, (net of accumulated depreciation of \$11,224)	25,077	–
	\$ 4,263,994	\$ 2,583,793

During the year ended June 30, 1996, the Company capitalized \$636,995 (1995 – \$266,524) of administrative overhead costs related to the exploration for petroleum and natural gas properties.

On March 15, 1995 the Company acquired the rights and interest of Scimitar Production Ltd. ("SPL"), a company controlled by a director of the Company, in a concession agreement in the United Arab Emirates and a Memorandum of Understanding including the right to enter into a Production Sharing Agreement in Mozambique.

The purchase price of \$2,378,000 paid by the Company was the aggregate cost incurred by SPL in acquiring the rights and interest referred to in the aforementioned agreement and Memorandum of Understanding. The consideration for the acquisition was the issue by the Company of 9,900 shares of the Company at an ascribed aggregate value of \$2,086,250, the assumption of indebtedness incurred by SPL of \$291,750 in the form of accounts payable of \$116,000 and a note payable of \$175,750.

### 5. Due to related parties:

Amounts due to related parties are unsecured, non-interest bearing and are repayable on demand.

### 6. Share capital:

#### (a) Authorized:

Unlimited number of common shares  
50,000,000 non-voting preferred shares



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (cont.)

### (b) Issued:

	Number of Shares	Amount
Shares issued for cash on March 15, 1995	100	\$ 140
Issued upon acquisition of petroleum and natural gas properties (note 4)	9,900	2,086,250
Balance, June 30, 1995	<u>10,000</u>	<u>\$ 2,086,390</u>
Common share capital of Commonwealth at time of acquisition	3,614,274	—
Issued on acquisition of SPIL	5,000,000	377,222
Issued through private placements for cash	2,328,230	1,164,115
Issued through private placements for shares	630,000	396,900
Stock options exercised for cash	201,706	45,141
Issued in lieu of salary	16,307	12,556
Issued on exercise of warrants	883,793	662,845
Share issue costs	—	(36,925)
Balance, June 30, 1996	<u>12,674,310</u>	<u>\$ 4,708,244</u>

### (c) Stock options:

The Company has a stock option plan under which the Board of Directors may grant stock options to directors, officers, employees and key consultants for the purchase of common shares. At June 30, 1996, the Company has reserved for issuance a total of 780,000 common shares under the Stock Option Plan. The options vest immediately, are exercisable at \$0.44 per share and expire on November 10, 2000.

### (d) Warrants issued and outstanding:

	Warrants	Exercisable to to Common Shares	Price	Expiry Date
Balance, Jun. 30, 1995	—	—	\$ —	
Private placement	500,000	300,000	0.75	Apr. 30, 1996
Private placement	2,758,230	2,758,230	0.75	May 10, 1996
			1.25	Nov. 10, 1996
Exercised for cash	(883,793)	(883,793)	0.75	
Balance, Jun. 30, 1996	<u>2,174,437</u>	<u>2,174,437</u>		

## 7. Segmented information:

In 1996, the Company continued the majority of its exploration activities in Mozambique and the United Arab Emirates ("UAE"). The accounting policies are consistent for both segments.

June 30, 1996	UAE	Mozambique	Other	Total
Corporate expenses				\$ 314,745
Net loss				\$ 314,745
Identifiable assets	\$ 2,860,431	\$ 1,323,481	\$ 80,082	\$ 4,263,994
Corporate assets				583,986
Total assets				\$ 4,847,980
June 30, 1995 (Unaudited)	UAE	Mozambique	Other	Total
Identifiable assets	\$ 1,936,910	\$ 646,883	\$ -	\$ 2,583,793
Corporate assets				2,769
Total assets				\$ 2,586,562

## 8. Subsequent event:

On October 8, 1996, the Company completed a private placement of 3,547,322 units at a price of \$0.85 per unit for proceeds of \$3,015,224. Each unit consisted of one common share and one common share purchase warrant entitling the warrant holder to purchase one common share at a price of \$1.25 per share until March 30, 1998.



## BOARD OF DIRECTORS

**Gerald A. Mackenzie** (Ajman, United Arab Emirates)

- Chairman of the Board, Scimitar Hydrocarbons Corporation
- Chairman of the Board, Scimitar Production International Ltd. (100% owned by SHC)

**Angus A. Mackenzie\*** (Montego Bay, Jamaica)

- Independent Businessman
- Director, Kappa Energy Company Inc.

**Mark R. Smith\***, B.Comm., LL.B. (Calgary, Canada)

- Secretary to the Board of Directors
- Partner, Burnet, Duckworth & Palmer (Barristers and Solicitors)

**Robert Stewart\*** (Cochrane, Canada)

- Independent Businessman
- Former Director, Commonwealth Energy Inc.

*\*audit committee member*

## EXECUTIVE OFFICERS AND KEY MANAGEMENT

**Mark R. Smith**, B.Comm., LL.B. (Calgary, Canada)

- Managing Director, and Secretary to the Board of Directors
- Partner, Burnet, Duckworth & Palmer (Barristers and Solicitors)

**John L. Dragonetti**, B.A., M.A. (Dubai, United Arab Emirates)

- Director, Operations
- President, Scimitar Production International Ltd. (100% owned by SHC)

**Gordon D. Holden**, P. Eng., M.Sc. [Dist.] (Calgary, Canada)

- Director, Projects

**Grant H. Grimsrud**, P. Eng., M.Sc. (Calgary, Canada)

- Director, Technical

**Bill G. Calsbeck** (Vancouver, Canada)

- Director, Investor Relations
- Former Director, and Vice-President Finance, Commonwealth Energy Inc. and Scimitar Hydrocarbons Corporation

**Maseliha Niheriwa**, B.Sc., M.Sc. (Maputo, Mozambique)

- Assistant General Manager, Mozambique

## SOLICITORS

Burnet, Duckworth & Palmer  
Calgary, Canada

## BANKERS

Royal Bank of Canada      The Hongkong Bank of Canada  
Calgary, Canada              Calgary, Canada

## AUDITORS

KPMG  
Calgary, Canada

## REGISTRAR & TRANSFER AGENT

The R-M Trust Company  
Calgary, Canada

## LISTING INFORMATION

Common shares: Symbol "SIY"  
on The Alberta Stock Exchange

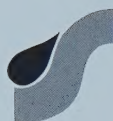
## SHARE PRICE HIGHS (to Oct. 15)



## SHARE TRADING INFORMATION

	Calendar		
	Q1/96	Q2/96	Q3/96
High	0.90	1.25	1.48
Low	0.56	0.80	0.85
Close	0.85	1.02	1.20
Vol. (millions)	2.06	1.91	4.16

*\*trading as Commonwealth Energy Inc. from Jan. 1, 1996 to Feb. 7, 1996*



## **SCIMITAR HYDROCARBONS CORPORATION**

300 Canada Place, 407 Second Street, S.W.  
Calgary, Alberta, CANADA, T2P 2Y3  
Telephone: +1 403 543-0333 Fax: +1 403 543-0344  
E-mail: [scimitar@agt.net](mailto:scimitar@agt.net)

### **SCIMITAR PRODUCTION INTERNATIONAL LTD.**

Caixa Postal 1255, Avenida Patrice Lumumba 178  
Maputo, Mozambique  
Telephone: +2581 429-302 Fax: +2581 429-380  
E-mail: [scimitar@mozmh.uem.mz](mailto:scimitar@mozmh.uem.mz)

### **SCIMITAR PRODUCTION INTERNATIONAL LTD.**

PO Box 3877, Ajman, United Arab Emirates  
Telephone: +971 6-456543 Fax: +971 6-457305  
E-mail: [dragon@emirates.net.ae](mailto:dragon@emirates.net.ae)

Common Shares listed on  
The Alberta Stock Exchange  
Symbol: "SIY"